Bang for Your Buck

The Purchasing Power Game

Did you receive a cost-of-living adjustment in your paycheck last year? Unless your pay went up by about 3 percent you were losing purchasing power. Purchasing power is the measure of what your earnings can buy. For consumers, purchasing power is determined by the level of inflation as measured by the Consumer Price Index (CPI). Did your pay go up by 3 percent or more? If not, you lost purchasing power and your standard of living dropped.

Controlling inflation is a primary goal of federal monetary policy—that's the job of the Federal Reserve System. Controlling inflation is very important because inflation affects the value (purchasing power) of the dollar. That dollar can be in a business account, a personal account, a retirement portfolio, a government budget, or social security benefits. The point is inflation affects everyone interacting in the economy.

Most consumers make the direct connection with inflation through what their everyday dollars will buy. Where do those dollars come from? They come from the paycheck. Improving your overall economic position means increasing your income to where the wage gain is greater than the rate of inflation. Workers may not realize that unless their paychecks go up by more than the rate of inflation, they are actually losing money or purchasing power.

How did Utah workers do in the purchasing power game over the last 10 years?

On average, you needed to increase your wages by about 28 percent over the 1997 to 2007 period just to break even and maintain purchasing power. In general, employees received increases in pay of 42 percent between 1997 and 2007 (see graph). Workers not only maintained their purchasing power but also increased their earnings above inflation by another 14 percentage points. Remember that the 10-year 42-percent increase in average wages by Utah employees includes performance (merit) increases and any cost-of-living adjustments. Most of the 42-percent increase likely resulted from promotions or performance increases.

The primary reason wages increased significantly was from growth—a booming economy. With the exception of a slowdown between about 2001 and 2004, the state had low unemployment and demand for workers was high. This resulted in upward pressure on wages as employers competed for available workers/skills in the labor market. The good news was that businesses were thriving and adding employees. The not-so-good news for employers (not workers) was that this demand was drying up the labor pool and creating worker shortages, thus driving up wages. Did you benefit from this growth?

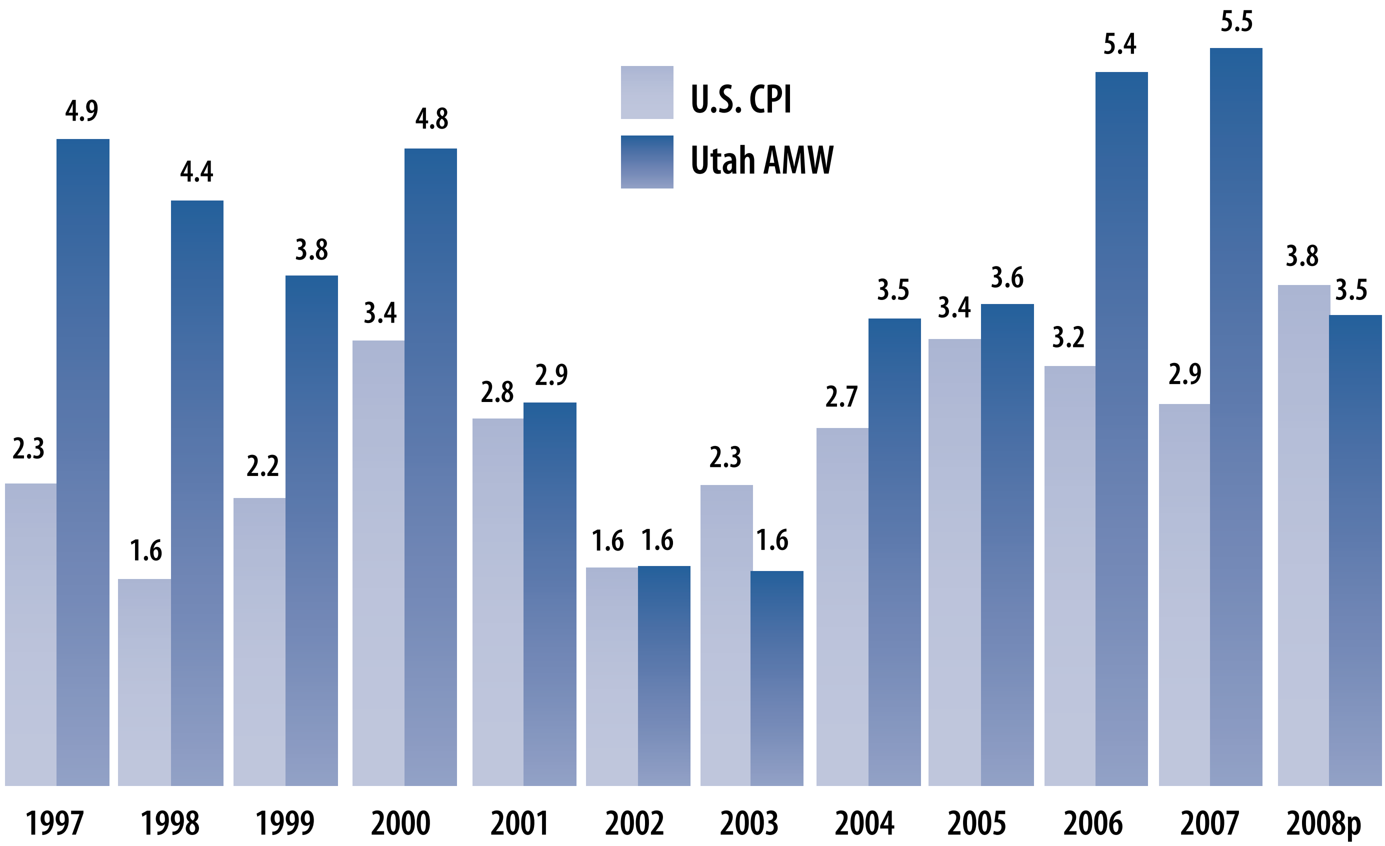
An Example

Let's say that in 2006 your earnings—your paychecks—totaled $32,000. That's your gross wage for the year (not your net after taxes and other deductions). In 2007 your checks added to $34,000. Your pay increased by 6.3 percent. Sounds good, right? Now adjust for inflation by subtracting the rate of inflation for 2007 of 2.9 percent from your gross increase of 6.3 percent. Your "real" inflation-adjusted increase in pay was 3.4 percent (6.3 percent—the total increase in pay less the amount of the increase accounted for by inflation—2.9 percent). Your purchasing power increased by 3.4 percent—that's good!

Pay increases are great but just remember that the purchasing power of the dollar is what is important, and adjust for that to get the true meaning of that big raise!

On average, you should have increased your wages by about 28 percent over the 1997 to 2007 period just to break even and maintain purchasing power.

Comparison of the Change in the U.S. Consumer Price Index & the Utah Average Monthly Wage • 1997-2007



Source: Bureau of Labor Statistics and Department of Workforce Services, March 2009.

For more information on inflation and the cost-of-living see:

- http://jobs.utah.gov/opencms/wi/pubs/costofliving/cost.html
- http://www.bls.gov/cpi/home.htm
- http://jobs.utah.gov/opencms/wi/pubs/costofliving/current.html